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SUBJECT: GERMAN RESPONSE TO DEMARCHE ON FINANCIAL CRISIS IN EASTERN AND CENTRAL EUROPE

REF: STATE 23758

Classified By: CHARGE D'AFFAIRES JOHN KOENIG FOR REASONS 1.4 (b) and (d)

¶1. (C) SUMMARY. In a discussion of G-20 themes with Ministry of Finance contacts, Embassy learned that the German government still believes strengthening financial sector regulation is the best way to restore confidence in the markets, and should thus be the primary focus of the April 2 London Summit. Although one cannot rule out a third fiscal stimulus later in the year, the Germans are focusing on implementation of the first two packages. On bailouts of EU countries facing possible default, EU countries including Germany would ride to the rescue should a member country need help. The International Monetary Fund (IMF), however, is the preferred choice for struggling non-EU countries. Germany hopes the G-20 will make a strong commitment to beef up IMF resources. Chancellor Merkel is expected to raise her idea for a new Economic Charter at the London Summit. END SUMMARY.

¶2. (C) On March 13, 2009, EMIN met with Rolf Wenzel, Director General, Financial Market Policy, Federal Ministry of Finance, to press U.S. priorities for the upcoming April 2, 2009 G-20 Summit in London, including effective and timely European support for countries in Central and Eastern Europe (CEE) (REFTEL). Separately, Econoff met with Steffen Meyer, Head of Division, World Economy, Currency Issues, IMF and G7, also of the Finance Ministry, and discussed many of the same topics covered in the demarche. Wenzel and Meyer are deeply involved in preparations for the April 2, 2009 G-20 Summit in London.

G-20 FOCUS: STIMULUS VS REGULATION

¶3. (C) EMIN explained the importance of committing to further action to spur growth, noting that this should be a major focus of the G-20 Summit in London. He added that the President would also push for financial sector reforms and assistance to struggling emerging economies at the Summit. Wenzel responded that German Chancellor Angela Merkel and French President Sarkozy, who had met the previous day in Berlin, agreed that strengthening the financial system should be the primary focus of the Summit. The G-20 now needed to implement the November 15, 2008 Summit Action Plan, which, he noted, had been approved under U.S. chairmanship. The plan encompassed both short- and long-term measures, he said, and addressed the crucial issue of "excessive risk taking." Wenzel acknowledged that secondary issues such as curbs on executive compensation and regulations of hedge funds would not solve the immediate crisis, but contended that strengthening financial regulation in general could help instill much needed confidence in the markets, which in turn

would support the recovery.

¶4. (C) Meyer told Econoff that, despite media headlines to the contrary, Germany understood the importance of stimulating demand, and noted that total German stimulus measures were worth 3.5 percent of (2008) GDP over two years. He explained the figure included two stimulus packages (totaling 81 billion euros), tax reductions from the deductibility of health care contributions not included in either package, as well as so-called "automatic stabilizers." (COMMENT: Meyer's estimate is generous, likely including some funds already in the pipeline and possibly double-counting others.)

¶5. (C) Our interlocutors contended a third stimulus was not currently in the works, and that the emphasis was now on implementing existing measures. Taking on more public debt was politically difficult in an election year, they explained. They did not rule out a third stimulus package completely, however, saying it would depend on how the economic situation evolved. If unemployment began to take off this summer, just before the September national elections, a third stimulus was entirely possible.

Global Imbalances

¶6. (C) We asked whether macroeconomic factors, such as chronic current account deficits in the U.S. and surpluses elsewhere, had contributed to the crisis. Wenzel thought these imbalances had little to do with it, and instead traced the roots of the crisis to the financial meltdown, which was deepening and prolonging a cyclical downturn. We heard, however, that Finance Minister Steinbrueck privately recognizes that Germany needs to boost consumption and move away from an over-reliance on exports; how they get there, of course, is still an open question.

CEE Bailout

¶7. (C) On the increasing difficulties of CEE countries, Wenzel agreed on the importance of maintaining financial and political stability in places like the Ukraine. (NOTE: In a separate meeting, MFA Head of Russia, Ukraine, and Central Asia Division Ernst Reichel told Poloff the MFA was increasingly concerned that the economic crisis -- combined with an already "dysfunctional political system, and Russian pressure" -- could lead to greater political instability in Ukraine.) The Finance Ministry felt the International Monetary Fund (IMF) should take care of countries outside the eurozone facing difficulties.

¶8. (C) Our interlocutors did not believe any eurozone member was on the verge of default, although they did acknowledge "political instability" in Greece. They underscored that the EU's balance of payment (BOP) facility was available to EU countries only. EU finance ministers meeting earlier in the week decided not to raise the BOP facility above 25 billion euros, because they reportedly feared doing so might send the wrong signal, spooking the markets. If a default by an EU member were imminent, the reasoning went, the BOP facility could be increased quickly or the EU could find another solution without involving the IMF or other outside institutions.

IMF

¶9. (C) Wenzel was confident that G-20 leaders would reach a consensus on the proposals to increase the IMF's New Arrangements to Borrow (NAB) to $500 billion. Germany, however, preferred doubling rather than tripling IMF funds. Germany would also like to retain the influential role of the IMF Board as a counterweight to the Managing Director, as Germany is concerned about the latter's growing influence. Our interlocutors hinted at differences between France and Germany on this point by suggesting a common EU position on

IMF reform was not necessary, and countries could act independently. The reason that China was so underrepresented in the IMF, they said, was due mainly to the UK and France, which "conspire to keep their combined weight above that of China." Germany would favor doubling the base representation, which would benefit Africa. Representation according to size of the economy should remain the guiding principle.

Economic Charter

¶10. (C) Finance Ministry representatives reported that the Chancellor intended to raise the concept of a "Charter for Sustainable Economic Activity" at the G-20 Summit. One idea is reportedly to get G-7 or G-8 countries to sign on first, and then bring in the G-20 and others. Echoing what we had learned previously from the Chancellery and other sources, existing instruments and "acquis" of international organizations like the OECD would form the core of the Charter. This would mean that G-7 countries would already be signatories to much of the Charter's precepts. The Charter would seek to link various existing agreements, and then "fill in the gaps." In doing so, Germany hoped to extend "tax-related provisions to certain neighboring countries to the south." Merkel,s idea for a World Economic Council was "way, way off" in the future, in the view of the Finance Ministry officials.

COMMENT

¶11. (C) The German Finance Ministry clearly understands the importance of both the fiscal and regulatory imperatives for the G-20 Summit in London. They believe they have a strong working relationship with their Treasury Department contacts, and appreciate the U.S. commitment to boosting growth, strengthening regulation, and assisting emerging economies. Public statements by Merkel and Steinbrueck calling for measures to rein in unbridled, "Anglo-Saxon," "robber-baron capitalism" are mostly pitched to domestic audiences, our contacts suggested. The timing, just before the meeting of G-20 Finance Ministers in the UK, was probably also tactical, with the Europeans positioning themselves as negotiations intensify. Germany is deeply concerned about stability in CEE countries, and is ready and willing to assist both inside and outside the eurozone. Doing so multilaterally is politically easier, however, so Germany is keen to ensure the IMF and other multilateral organizations have the resources to act in an emergency if necessary.

Koenig